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Decision 04-04-071 April 22, 2004

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of San Diego Gas & Electric Company ("SDG&E") for Authority to Implement a Distribution Performance-Based Ratemaking Mechanism (U 904-M)	Application 98-01-014 (Filed January 16, 1998)
In the Matter of the Application of Southern California Gas Company To Adopt Performance Based Regulation ("PBR") for Base Rates to be Effective January 1, 1997 (U 902-M)	Application 95-06-002 (Filed June 1, 1995)
Joint Application of Pacific Enterprises, Enova Corporation, Mineral Energy Company, B Mineral Energy Sub and G Mineral Energy Sub for Approval of a Plan of Merger of Pacific Enterprises and Enova Corporation with and into B Energy Sub ("Newco Pacific Sub") and G Energy Sub ("Newco Enova Sub"), the Wholly-Owned Subsidiaries of a Newly Created Holding Company, Mineral Energy Company.	Application 96-10-038 (Filed October 30, 1996)
Application of Southern California Gas Company for Authority to Update Its Gas Revenue Requirement and Base Rates. (U 904-G)	Application 02-12-027 (Filed December 20, 2002)
Application of San Diego Gas & Electric Company for Authority to Update Its Gas and Electric Revenue Requirement and Base Rates. (U 902-M)	Application 02-12-028 (Filed December 20, 2002)

ORDER CLARIFYING D.04-01-007 AND DENYING REHEARING

I. SUMMARY

San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) (collectively, "Applicants") filed a joint application for the rehearing of D.04-01-007 (the Decision), which granted with modification SDG&E's and SoCalGas' petition for modification of D.01-10-030. The Decision authorized the extension of existing performance indicators for SDG&E and SoCalGas for test year 2004, but not the existing incentive mechanisms. This decision denies rehearing, but clarifies language on page 6 of the Decision to avoid confusion regarding the standard for Commission decisionmaking.

II. FACTS/BACKGROUND

On June 1, 1995, SoCalGas filed A.95-06-002, seeking for the first time authorization for a base rate performance-based ratemaking (PBR) program. On July 16, 1997, the Commission authorized a PBR mechanism for SoCalGas in D.97-07-054 (73 CPUC2d 469). The PBR mechanism adopted by the Commission was effective on January 1, 1998 for five years, unless SoCalGas elected an effective date of January 1, 1997; SoCalGas did not elect to do so. The PBR mechanism was to end on December 31, 2002.

The SoCalGas PBR decision adopted performance indicators related to such variables as customer satisfaction, service quality, and employee safety. There were associated financial incentives if the utility exceeded or failed to meet the standards set.[1]

[1] Performance targets were established for customer satisfaction with the Service Representative, customer satisfaction with the scheduling of field service call appointments, satisfaction with the field Appliance Service Representative, and the percentage of on-time arrivals for service calls. SDG&E is eligible for penalties and rewards if its actual performance is below or above target levels, i.e., outside a deadband (D.99-05-030; 86 CPUC2d 327). On the other hand, SoCalGas is not eligible for rewards for exceeding performance targets.

Annual targets were based on average performance for 1994 through 1996 for each of the performance categories.

On January 16, 1998, SDG&E filed A.98-01-014, requesting authority to implement a distribution PBR mechanism. A settlement agreement resolving cost of service issues was adopted in D.98-12-038 (83 CPUC2d 363). SDG&E and other parties also engaged in disputes concerning performance indicators. Negotiations among those parties resulted in the filing of a PBR performance indicator Settlement Agreement in A.98-01-014. This second all-party settlement agreement resolved the "performance indicators," such as measures of safety, reliability, customer satisfaction, and call center responsiveness that would also be a part of the overall PBR mechanism. On May 13, 1999, the Commission issued D.99-05-030 (86 CPUC2d 327), approving the settlement agreement on performance indicators.

On October 10, 2001, the Commission issued D.01-10-030 in A.95-06-002 and A.98-01-014. In that decision, the Commission extended SoCalGas and SDG&E's PBR mechanisms, including the performance indicators, by one year, through 2003, and the test year for their next cost of service applications was changed from test year 2003 to test year 2004. On August 26, 2003, SDG&E and SoCalGas jointly petitioned the Commission to modify D.01-10-030 to extend the 2003 performance indicators through 2004.

SoCalGas and SDG&E sought by consolidated applications (A.02-12-027 and A.02-12-028) filed on December 20, 2002 to adopt new incentive mechanisms for both companies applicable to a test year 2004. Assigned Commissioner and Administrative Law Judge (ALJ) ruling dated May 22, 2003 bifurcated that proceeding.[2] Pursuant to the ruling, their incentive proposals will be considered in Phase II of those applications. Therefore, the authorization of any incentive mechanism will not be considered before

[2] *Assigned Commissioner's Ruling Establishing Scope, Schedule and Procedures for Proceeding* dated April 2, 2003 (Scoping Memo), and *Ruling Clarifying the Scoping Memo and Modifying the Schedule* dated May 22, 2003. The ruling was made in response to SoCalGas and SDG&E's Motion for Reconsideration on April 19, 2003 of the Assigned Commissisoner's April 2, 2003 Scoping Memo.

the start of test year 2004. On January 12, 2004, the Commission issued D.04-01-007, which authorizes current performance indicators, but not the existing financial incentives for SDG&E and SoCalGas, to continue through the end of 2004.

On February 10, 2004, SDG&E and SoCalGas timely filed a joint application for rehearing. The utilities allege that the Decision erred in finding that extension of the incentive mechanisms through 2004 is not reasonable because there is substantial evidence supporting extending the incentives and ample Commission precedent for simultaneously extending both performance indicators and associated penalty/reward structures. Moreover, they contend it is unfair, inefficient, and unlawfully violates PU §728 for the Commission to apply a penalty/reward structure retroactively to performance in a period before the mechanisms are adopted.

On March 1, 2004, Utility Consumers' Action Network (UCAN) and The Utility Reform Network (TURN) filed a Motion for Acceptance of Late-Filed Response, along with the Response, to SDG&E's and SoCalGas' rehearing application. Since no one is prejudiced thereby, the motion is granted. UCAN and TURN state that their failure to file a response to SDG&E's and SoCalGas' joint petition for modification does not indicate support or even neutrality with regard to the petition to modify, that it merely means that the utilities' request came at a time when they were unable to respond. They further argue that based on the current evidentiary record in the cost of service proceeding, the Commission is well within its authority and was correct in choosing to suspend the economic incentives in SDG&E's and SoCalGas' PBR mechanism.

III. DISCUSSION

A. The Decision Is Based on Substantial Evidence and Is Correct in Concluding that the Extension of Previously Adopted Incentive Mechanisms through 2004 is Not Reasonable.

SDG&E and SoCalGas allege that the Decision errs in finding that extension of the incentive mechanisms through 2004 is not reasonable. They further maintain that there is ample Commission precedent to extend both performance indicators and

penalties/rewards. To support their allegations, SDG&E and SoCalGas single out Conclusion of Law No. 4, which states as follows: "It is not reasonable to extend the previously adopted financial incentive component of the performance indicators."[3] SDG&E and SoCalGas are simply wrong. They have not established legal error. Conclusion of Law No. 4 is not legal error, and it is reasonable and fact-based.

It is indisputable that the incentive mechanisms requested by SoCalGas and SDG&E in the consolidated A.02-12-027 and 02-12-028 were bifurcated, and the incentive mechanisms will be considered in Phase II of the proceeding. There will not be a Commission decision before the start of test year 2004. (Finding of Fact No. 2; see May 22, 2003 Ruling Clarifying the Scoping Memo and Modifying the Schedule.) The record does not support a finding that extending the current PBR incentive mechanisms is reasonable for test year 2004. Without an adequate record, the Commission is not in a position to know whether any financial incentive mechanism is reasonable for test year 2004. (See Finding of Fact No. 3) Phase II of A.02-12-027/028 may determine whether or not it is reasonable to adopt financial incentives for all or a portion of test year 2004. Until then, the uncertainty of whether current performance indicators are reasonable to reward company performance under current conditions makes it reasonable to separate performance indicators from incentives. We affirm D.04-01-007's conclusion that extending the existing performance indicators does not prejudge the need for, or the use of, any potential financial incentive mechanism that may be adopted for test year 2004.

Because the record does not support a finding that it is reasonable under the circumstances to adopt financial incentives for all or a part of test year 2004, we decline to make such a finding. Accordingly, we find, as did D.04-01-007, that the record is not adequate to extend the financial incentives through 2004, and therefore it is unreasonable to do so:

> The Commission has no certain knowledge of whether the current performance indicators are reasonable as a standard

[3] D.04-01-007, *mimeo*, p. 10.

> for rewarding shareholders for company performance under current conditions. Phase II could determine either that no financial incentive mechanism is currently warranted, or that the current performance indicators are inadequate or otherwise inappropriate for an incentive mechanism in 2004. Therefore any extension of the performance indicators must be seen as separate from a determination by the Commission that it will adopt any financial reward or penalty mechanism that will rely on them.[4]

SDG&E and SoCalGas take issue with the use of "certain knowledge" and equate it with the Commission's standard for decisionmaking. They are misguided. As TURN and UCAN correctly perceived, the Commission was not fashioning a new standard. (TURN's and UCAN's Rhg. Response, p. 3.) The Commission is well aware that the standard is substantial evidence, as required by PU Code §1757(a).[5] However, to prevent others from misconstruing the standard for Commission decisionmaking, the sentence will be modified as indicated in this order.

Regarding SDG&E's and SoCalGas' assertion that there is Commission precedent for simultaneously extending both performance indicators and their associated penalties/rewards, we do not find this argument to be persuasive because the Commission is not bound by its own precedent. (*In re Pacific Gas & Electric Co.* (1988) 30 CPUC2d 189, 223-225) It is not legal error for the Commission to deviate from prior Commission decisions. The California Supreme Court explained this long-held principle as follows:

> The departure by the Commission from its own precedent or its failure to observe a rule ordinarily respected by it is made the subject of criticism, but our reply is that this is not a matter under the control of this court. We do not perceive that such a matter either tends to show that the Commission had not regularly pursued its authority, or that said departure violated any right of the petitioner guaranteed by the state or

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[4] D.04-01-007, *mimeo*, p. 6.

[5] Section 1757(a)(4) requires the findings in Commission decisions to be supported by substantial evidence in light of the whole record.

> federal constitution. Circumstances peculiar to a given situation may justify such a departure.[6]

As the Court recognized, the circumstances of a given situation may justify departing from Commission precedent. Such is the case here.

B. The Commission's Application of a Penalty/Reward Mechanism to Performance in 2004 Does Not Constitute Retroactive Ratemaking.

SDG&E and SoCalGas assert that any retroactive application by the Commission of a penalty/reward structure adopted in Phase II of A.02-12-027/028 to performance in 2004 would be unlawful, unfair, and unreasonable. Specifically, they claim that any retroactive application of penalties/rewards to performance indicators violates PU Code §728 by fixing rates (i.e., the structure for rewards/penalties) retroactively.[7] This argument is baseless.

The Applicants attempt to support their allegations with statements such as, "the unfairness of adopting and applying a penalty/reward structure retroactive is obvious on its face," and "[i]t is unavoidable that knowing the results will prejudice the decision on rewards or penalties for that performance." (SDG&E & SoCalGas Rhg. App., p. 10.) These unsupported statements are unpersuasive.

The prohibition against retroactive ratemaking applies only to proceedings where general rates are being promulgated. (*So. Calif. Edison Co. v. P.U.C.* (1978) 20 Cal.3d 813.) However, the Court plainly placed limits on the application of §728:

> [W]e construed Public Utilities Code section 728 to vest the commission with power to fix rates prospectively only. But we did not require that each and every act of the commission operate solely in futuro; our decision was limited to the act

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[6] *Postal Telegraph-Cable Company v. Railroad Commission of the State of California* (1925) 197 Cal. 426, 436.

[7] PU Code §728 provides in pertinent part as follows: "Whenever the commission, after a hearing, finds that the rates…collected by any public utility for or in connection with any service… are insufficient, unlawful, unjust, unreasonable…, the commission shall determine and fix, by order, the just, reasonable, or sufficient rates… to be thereafter observed and in force."

> of promulgating 'general rates.'" (*So. Calif. Edison Co., supra* at 816.)

The Decision does not violate the rule against retroactive ratemaking. It does not revise or make adjustments to any customer rate. Providing a mechanism for rewards or penalties does not constitute retroactive ratemaking. This was made eminently clear in D.93-12-043, a rate case that directed SoCalGas to reduce base rates by $118 million. To SoCalGas' allegations challenging, on the basis of alleged retroactive ratemaking, the Commission's authority to impose penalties, the Commission responded as follows:

> [T]his Commission has both explicit and implicit authority to impose penalties on jurisdictional utilities and such penalties do not constitute retroactive ratemaking. DRA proposes a penalty, not a retroactive adjustment of rates.[8]

The crux of SDG&E's and SoCalGas' charges appears to be rooted in the Assigned Commissioner and ALJ ruling that bifurcated the consolidated A.02-12-027 and 02-12-028 proceeding, where it will take up incentive mechanisms in Phase II. Pursuant to this schedule, the Commission will not be able to consider the authorization of any incentive mechanism before the start of test year 2004. The Commission has not committed legal error by managing the proceedings in this manner. Article XII, section 2 of the California Constitution provides that the commission may, "[s]ubject to statute and due process . . .establish its own procedures." The California Supreme Court in *San Diego v. Superior Ct.* (1996) 13 Cal.4th 893, 914, acknowledged the Commission's constitutional authority to establish its own procedures. Since the current record does not make the case that previously adopted financial incentives should be continued, it would be unreasonable to extend them. By taking up financial incentives in Phase II of A.02-12-027/028, the Commission violates neither due process nor §728, and is well

[8] *Re Southern California Gas Co.* (1993) 52 CPUC2d 471, 514. The Division of Ratepayer Advocates (DRA) had proposed a $3 million penalty against SoCalGas for alleged failure to comply with D.97-03-039. The Commission declined to penalize SoCalGas because the decision was sufficiently vague that a penalty was not justifiable.

within its authority to extend the performance indicators without, at the same time, extending the incentive mechanisms.

IV. CONCLUSION

We have considered each and every allegation of legal error raised in SDG&E's and SoCalGas' rehearing application of D.04-01-007, and are of the opinion that legal error was not demonstrated. Accordingly, we deny rehearing. However, we clarify language on page 6 of the Decision to avoid confusion regarding the standard for Commission decisionmaking.

Therefore **IT IS ORDERED** that:

1. Page 6, first full paragraph, second sentence is revised to read as follows:

   The Commission cannot, and should not, prejudge, both as a matter of principle and because to do so would constitute reliance on an inadequate record, whether the existing financial incentive component of performance indicators is reasonable as a standard to be used in test year 2004.

2. UCAN's and TURN's Motion for Acceptance of Late-Filed Response to Application for Rehearing is granted.

3. SDG&E's and SoCalGas' application for the rehearing of Decision 04-01-007, as clarified, is denied.

4. Applications (A.) 98-01-014, A.95-06-002 and A.96-10-038 are closed.

This order is effective today.

Dated April 22, 2004, at San Francisco, California.

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners